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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 916

FRANK L. WEIL, WILLIAM E. RUSSELL AND RAYMOND J. SCULLY, AS TRUSTEES UNDER A DECLARATION OF TRUST DATED APRIL 7TH, 1936 AND A PLAN OF REORGANIZATION OF SERIES C-2 MORTGAGE INVESTMENTS APPROVED BY AN ORDER OF THE SUPREME COURT OF THE STATE OF NEW YORK ENTERED ON THE 16TH DAY OF JANUARY, 1936,

Petitioners,

vs.

THE UNITED STATES OF AMERICA.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable The Chief Justice and Associate Justices of the Supreme Court of the United States:

Summary Statement of Matter Involved.

This case challenges the right of the United States Government to exact a documentary stamp tax on the transfer of certain corporate bonds under and pursuant to the pro-

visions of Schedule A-9, Title VIII of the Revenue Act of 1926, as amended by Section 724A of the Revenue Act of 1932 (R. 6, 7, 14) (Appendix, p. 29).

The taxing statute and the pertinent Treasury Regulations, insofar as these transfers are concerned, are set forth in the appendix hereto at pp. 29-32.

The transfers upon which the tax was exacted were the assignments of corporate bonds, securing the payment of various indebtednesses further secured by first mortgages on real estate (R. 5, 6, 9, 10). The transfers were from Louis H. Pink, Superintendent of Insurance of the State of New York, as Liquidator of the New York Title and Mortgage Company (hereinafter referred to as the "Superintendent") and Mortgage Commission of the State of New York (hereinafter referred to as "Mortgage Commission") to Frank L. Weil, William E. Russell and Raymond J. Scully as Trustees of Series C-2 mortgage investments issued and guaranteed by New York Title and Mortgage Company, petitioners herein (R. 6).

The New York Title and Mortgage Company (hereinafter referred to as "Guarantee Company") was one of many companies engaged in the business of making loans secured by bonds and first mortgages. Undivided interests in these bonds and mortgages, called certificates, were then sold to investors with an accompanying guaranty of principal and interest by the Guarantee Company. Where undivided interests in a single bond and mortgage were sold, it was identified as an individual issue, and where undivided interests in pools of bonds and mortgages were sold, they were identified as group issues. Among these group issues was one with over 100 bonds, mortgages and properties, representing $24,184,788.54 in principal amount, sold to approximately 7500 investors, which constituted the Series C-2 issue of the Guarantee Company (R. 3).

In 1933, there was a complete and general collapse of all of these companies, caused by a variety of economic factors, which resulted in part from the unprecedented decline in real estate values and the oppressive obligations represented by the guaranties which the companies were required to meet (R. 3).

In order to avert a major economic disaster, these companies were taken over for rehabilitation by the Superintendent pursuant to Article XI of the New York State Insurance Law. The powers conferred by this section, however, were inadequate to enable the Superintendent to administer and reorganize the properties and mortgages involved for the benefit of the investors. In order to supplement the powers granted to the Superintendent by Article XI of the Insurance Law, the "Schackno Act" (Chapter 745, New York Laws 1933, as amended, Unconsolidated Laws of New York, Sections 1796-1807 inclusive) was enacted (R. 4 and appendix pp. 32-38).

The "Schackno Act" also embodied the legal and procedural mechanism for plans of reorganization resulting in the appointment of permanent trustees as successors to the Superintendent and later the Mortgage Commission (Appendix pp. 32-38).

Pursuant to the provisions of Article XI, as supplemented by the "Schackno Act", the Superintendent acquired legal title to all bonds and mortgages representing the issues of the Guarantee Company, including the Series C-2 issue (R. 4).

It is conceded by the government that the transfers from the Guarantee Company to the Superintendent, pursuant to Article XI of the Insurance Law of the State of New York and the Schackno Act, were wholly by operation of law and, therefore, not taxable.

Despite the implementation of the Insurance Law by the Schackno Act, the office of the Superintendent was found

to be equipped neither to administer temporarily nor to reorganize the vast number of issues involved. This reason, among others, caused the New York State Legislature to create a separate State agency to assume the burden of administering temporarily and reorganizing these issues in the place of the Superintendent. (Section 1 of the Declaration of Cause, Chapter 19 of the Laws of 1935, as amended, appendix, pp. 38-41.)

Hence, by the Mortgage Commission Act (N. Y. Laws 1935, Chapter 19, as amended) the Mortgage Commission was created as a provisional organization and its existence was limited to January 1, 1940 (Appendix, p. 57). The sole function of the Mortgage Commission was the temporary administration and reorganization of the guaranteed mortgage properties pending judicially approved reorganizations effecting a final turnover to permanent trustees.

The Mortgage Commission Act incorporated by reference those provisions of the Schackno Act which created the statutory machinery for the promulgation of plans of reorganization (Appendix, pp. 45, 54, 55). In addition thereto, the Mortgage Commission Act provided for an alternative legal and procedural mechanism for the promulgation of these plans (Appendix, p. 48). Either procedure required reorganization upon court order. According to the Schackno Act procedure, prior to the making of the court order, the holders of two-thirds in principal amount of the certificates outstanding in any particular issue were required to consent (Appendix, p. 36). According to the Mortgage Commission Act procedure, a court order could be made approving the plan, if the holders of one-third in principal amount of the certificates outstanding failed to dissent (Appendix, pp. 49-50).

Pursuant to the Mortgage Commission Act, the Mortgage Commission acquired title to the securities underlying the various issues, including those of Series C-2, and became

Trustee for the benefit of certificate holders (the *cestuis*), (R. 4). The Mortgage Commission Act, defining and limiting its powers, was the declaration of trust under which it acted (McKinney's Unconsolidated Laws of New York, Sections 1751-1785 incl.).

The transfers of securities from the Superintendent to the Mortgage Commission pursuant to the Mortgage Commission Act were conceded by the Government to be "wholly by operation of law", and not taxable.

The instant case employed the mechanism of the "Schackno Act" to effectuate the transfers from the Mortgage Commission to permanent trustees, the petitioners herein. To this end, the Mortgage Commission promulgated a plan which, after a hearing, was approved by the interlocutory order of Mr. Justice Alfred Frankenthaler of the New York Supreme Court, who had exclusive judicial supervision of the guaranteed mortgage situation in New York County. Thereupon, the Mortgage Commission obtained the consent of the holders of two-thirds in principal amount of the certificates outstanding. The plan was then approved by the Supreme Court of the State of New York by final order dated January 15, 1936. The Trustees, petitioners herein, were appointed by Mr. Justice Frankenthaler to act under a declaration of trust approved by him (R. 5). Immediately upon their qualification, title vested in the petitioners (R. 50, 51) by virtue of the specific provisions in the court order and the plan (R. 50, 51, 91) and in accordance with authority contained in the statute (Appendix, p. 48). They were to liquidate the issue for the benefit of the holders according to the terms of the Declaration of Trust and the plan of reorganization (R. 60).

Over protest, the government collected from the petitioners a tax of $6,361.64 on the transfers of the corporate bonds to them from the Mortgage Commission.

On May 11th, 1938, petitioners filed with the Commissioner of Internal Revenue a claim for refund which was disallowed on September 24, 1938 (R. 7).

Petitioners then instituted this suit in the District Court for the Southern District of New York to recover the tax paid (R. 2-10, inclusive). No issue of fact having been raised by the pleadings, both sides moved for summary judgment (R. 16-95, inclusive). These motions were argued before Hon. Henry W. Goddard, District Judge. Pursuant to the court's opinion, filed on November 8th, 1938 (R. 96-102, inclusive) an order was entered in that court granting petitioners' motion for summary judgment, striking out the Government's answer and denying the Government's motion. Judgment was thereupon entered on November 2nd, 1939, in favor of the petitioners for $6,361.64, with interest thereon and costs in the amount of $5.00 (R. 103-105, inclusive).

The Government appealed to the Circuit Court of Appeals for the Second Circuit (R. 106). By order entered January 2nd, 1941 (R. 118, 119), the judgment of the District Court was unanimously reversed pursuant to the opinion of Hon. Augustus N. Hand, Circuit Judge, filed on December 16, 1940 (R. 111-117, inclusive).

Opinions Below.

The opinion of the Circuit Court of Appeals for the Second Circuit (R. 111-117) is reported in 115 F. (2d) 999, and that of the District Court for the Southern District of New York (R. 96-102) is reported in 30 Fed. Supp. 349.

Basis of Decision of the Court Below.

The court below held the transfers herein taxable for the following reasons:

1. That this Court had construed the taxing statute literally and was altogether strict in subjecting the transfers

to a tax. *Raybestos-Manhattan, Inc.* v. *U. S.*, 296 U. S. 60; *Founders General Corp.* v. *Hoey*, 300 U. S. 268; *Koppers Coal and Transportation Co.* v. *U. S.*, 107 F. (2d) 706.

2. That the two-thirds consent of the certificate holders was a voluntary act and therefore the transfer was not wholly by operation of law.

3. That although New York law held similar transfers to be by operation of law (*Terminals Transportation Corp.* v. *State*, 169 Misc. 708, 8 N. Y. Supp. (2d) 282, affd. 14 N. Y. Supp. (2d) 493, 281 N. Y. 889; #23; *Electric Bond and Share Company* v. *State*, 249 App. Div. 371, Affirmed 274 N. Y. 625) it must be disregarded in construing the statute here in question, *Burnet* v. *Harmel*, 287 U. S. 103.

Basis of Jurisdiction.

This is a petition for a writ of certiorari to review the final judgment of the Circuit Court of Appeals for the Second Circuit, reversing the judgment of the District Court for the Southern District of New York in favor of the petitioners and granting final judgment in favor of the Government, respondent. Jurisdiction is invoked under Section 240 (a) of the Judicial Code, as amended (Section 347a of Title 28 U. S. C. A.) (Appendix, p. 29).

The Question Presented.

Were the transfers of the corporate bonds herein effected "wholly by operation of law" and consequently exempt from taxation under Schedule A-9, Title VIII of the Revenue Act of 1926 (as amended by Section 724a of the Revenue Act of 1932) and Treasury Regulations 71?

Reasons Relied On for the Allowance of the Writ.

1. The Circuit Court of Appeals for the Second Circuit has decided erroneously, petitioners submit, an important

question of Federal law which has not been, but should be, settled by this Court.

The transfers in suit are prototypes of thousands of other transfers arising under the same New York statutes. A decision in this case will determine the taxability of such other transfers.

Pursuant to the Mortgage Commission Act, there were transferred approximately 15,000 properties and mortgages totalling over $675,000,000 in principal amount. A substantial proportion of these transfers were of corporate bonds which were, in effect, held taxable by the decision of the court below. These transfers involved over 250,000 individual certificate holders residing throughout the United States and in foreign countries.

This unwarranted Federal tax was imposed on scores of thousands of certificate holders whose life savings were jeopardized and depleted by the collapse of the mortgage guarantee companies.

The State of New York fully appreciated the plight of the certificate holders and created legislation to alleviate their distress by successive transfers of the bonds and mortgages securing their investments from the insolvent guarantee companies to two state agencies: first the Superintendent and then the Mortgage Commission, and, finally, to court appointed Trustees. These steps were merely part of a State statutory scheme to attempt to salvage these investments. These constructive ~~effects~~ of the State of New York will be vitiated to the extent that transfer taxes were imposed which will be permanently siphoned directly from the certificate holders unless the order herein made by the Circuit Court of Appeals is reversed.

2. The decision of the Circuit Court of Appeals for the Second Circuit in this case is in direct conflict with the decision of the Ninth Circuit in *U. S.* v. *Merchants National*

Trust and Savings Bank, 101 Fed. (2d) 399, in three respects. The conflicts concern the question of the application and controlling effect of State Law regarding the nature of the transfers herein and the interpretation and application thereto of Articles 35 (h) and 35 (r) of Treasury Regulations 71.

3. The Circuit Court of Appeals for the Second Circuit has decided a Federal question in conflict with applicable decisions of this Court concerning the controlling effect of State Law. *Morgan* v. *Commissioner,* 309 U. S. 78; *Lang* v. *Commissioner,* 304 U. S. 264, 267; *Blair* v. *Commissioner,* 300 U. S. 5, 9, 10; *Freuler* v. *Helvering,* 291 U. S. 35, 45; *Burnet* v. *Harmel,* 287 U. S. 103.

The decisions of the highest courts of the State of New York have held transfers identical in legal effect to those here in question to be by operation of law. *Terminals Transportation Corp.* v. *State,* 169 Misc. 708, Affirmed 281 N. Y. 889; *Electric Bond and Share Company* v. *State,* 249 App. Div. 371, Affirmed 274 N. Y. 625; *Rockefeller Foundation* v. *State,* 144 Misc. 460, 258 N. Y. Supp. 812; *Phelps-Stokes Estates* v. *Nixon,* 222 N. Y. 93. The court below, recognizing the New York law to be as stated, nevertheless held that such law was neither binding upon it nor controlling.

4. The transfers herein were not taxable under the Federal law and the court below erred in its application of the taxing statute to these transfers in two respects. The court failed to exempt the transfers from the tax pursuant to the provisions of Articles 35 (h) and 35 (r) of Treasury Regulations 71; *U. S.* v. *Merchants National Trust and Savings Bank,* 101 Fed. (2d) 399.

Wherefore, the petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of

this Honorable Court directed to the Circuit Court of Appeals for the Second Circuit commanding that court to certify and to send to this Court for its review and determination on a day certain to be therein named, a transcript of the records and proceedings herein; and that the order of said court entered on January 2nd, 1941 reversing the judgment of the District Court for the Southern District of New York be reversed by this Honorable Court and that petitioners have such other and further relief in the premises as to this Honorable Court may seem just and equitable.

EUGENE J. MORRIS,
Counsel for Petitioners.

STATE OF NEW YORK,
City of New York,
County of New York, ss:

Eugene J. Morris, being duly sworn, says that he is counsel for the petitioners named in the foregoing petition; that he prepared the same and that the allegations thereof are true as he verily believes.

EUGENE J. MORRIS,
Counsel for Petitioners.

Subscribed and sworn to before me this 1st day of April, 1941.

EVELYN R. LAHEY.

Notary Public, Westchester County. Cert. filed in N. Y. Co., No. 623, Reg. No. 1-L-377. Commission expires March 30, 1941.